

lapse of D's voting rights. D's gross estate includes an amount equal to the excess, if any, of the fair market value of D's stock (determined immediately after D's death as though the voting rights had not been reduced and would not be reduced) over the stock's fair market value immediately after D's death.

*Example 4.* D owns 84 percent of the single outstanding class of stock of Corporation Y. The by-laws require at least 70 percent of the vote to liquidate Y. D gives one-half of D's stock in equal shares to D's three children (14 percent to each). Section 2704(a) does not apply to the loss of D's ability to liquidate Y, because the voting rights with respect to the corporation are not restricted or eliminated by reason of the transfer.

*Example 5.* D and D's two children, A and B, are partners in Partnership X. Each has a 3⅓ percent general partnership interest and a 30 percent limited partnership interest. Under State law, a general partner has the right to participate in partnership management. The partnership agreement provides that when a general partner withdraws or dies, X must redeem the general partnership interest for its liquidation value. Also, under the agreement any general partner can liquidate the partnership. A limited partner cannot liquidate the partnership and a limited partner's capital interest will be returned only when the partnership is liquidated. A deceased limited partner's interest continues as a limited partnership interest. D dies, leaving his limited partnership interest to D's spouse. Because of a general partner's right to dissolve the partnership, a limited partnership interest has a greater fair market value when held in conjunction with a general partnership interest than when held alone. Section 2704(a) applies to the lapse of D's liquidation right because after the lapse, members of D's family could liquidate D's limited partnership interest. D's gross estate includes an amount equal to the excess of the value of all D's interests in X immediately before D's death (determined immediately after D's death but as though the liquidation right had not lapsed and would not lapse) over the fair market value of all D's interests in X immediately after D's death.

*Example 6.* The facts are the same as in *Example 5*, except that under the partnership agreement D is the only general partner who holds a unilateral liquidation right. Assume further that the partnership agreement contains a restriction described in section 2704(b) that prevents D's family members from liquidating D's limited partnership interest immediately after D's death. Under State law, in the absence of the restriction in the partnership agreement, D's family members could liquidate the partnership. The restriction on the family's ability to liquidate is disregarded and the amount of D's gross estate is increased by reason of the lapse of D's liquidation right.

*Example 7.* D owns all the stock of Corporation X, consisting of 100 shares of non-voting preferred stock and 100 shares of voting common stock. Under the by-laws, X can only be liquidated with the consent of at least 80 percent of the voting shares. D transfers 30 shares of common stock to D's child. The transfer is not a lapse of a liquidation right with respect to the common stock because the voting rights that enabled D to liquidate prior to the transfer are not restricted or eliminated. The transfer is not a lapse of a liquidation right with respect to the retained preferred stock because the preferred stock is not subordinate to the transferred common stock.

*Example 8.* D owns all of the single class of stock of Corporation Y. D recapitalizes Y, exchanging D's common stock for voting common stock and non-voting, non-cumulative preferred stock. The preferred stock carries a right to put the stock for its par value at any time during the next 10 years. D transfers the common stock to D's grandchild in a transfer subject to section 2701. In determining the amount of D's gift under section 2701, D's retained put right is valued at zero. D's child, C, owns the preferred stock when the put right lapses. Section 2704(a) applies to the lapse, without regard to the application of section 2701, because the put right was not valued under section 2701 in the hands of C.

*Example 9.* A and A's two children are equal general and limited partners in Partnership Y. Under the partnership agreement, each general partner has a right to liquidate the partnership at any time. Under State law that would apply in the absence of contrary provisions in the partnership agreement, the death or incompetency of a general partner terminates the partnership. However, the partnership agreement provides that the partnership does not terminate on the incompetency or death of a general partner, but that an incompetent partner cannot exercise rights as a general partner during any period of incompetency. A partner's full rights as general partner are restored if the partner regains competency. A becomes incompetent. The lapse of A's voting right on becoming incompetent is not subject to section 2704(a) because it may be restored to A in the future. However, if A dies while incompetent, a lapse subject to section 2704(a) is deemed to occur at that time because the lapsed right cannot thereafter be restored to A.

[T.D. 8395, 57 FR 4274, Feb. 4, 1992]

#### § 25.2704-2 Transfers subject to applicable restrictions.

(a) *In general.* If an interest in a corporation or partnership (an "entity") is transferred to or for the benefit of a

member of the transferor's family, any applicable restriction is disregarded in valuing the transferred interest. This section applies only if the transferor and members of the transferor's family control the entity immediately before the transfer. For the definition of control, see § 25.2701-2(b)(5). For the definition of member of the family, see § 25.2702-2(a)(1).

(b) *Applicable restriction defined.* An applicable restriction is a limitation on the ability to liquidate the entity (in whole or in part) that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in the absence of the restriction. A restriction is an applicable restriction only to the extent that either the restriction by its terms will lapse at any time after the transfer, or the transferor (or the transferor's estate) and any members of the transferor's family can remove the restriction immediately after the transfer. Ability to remove the restriction is determined by reference to the State law that would apply but for a more restrictive rule in the governing instruments of the entity. See § 25.2704-1(c)(1)(B) for a discussion of the term "State law." An applicable restriction does not include a commercially reasonable restriction on liquidation imposed by an unrelated person providing capital to the entity for the entity's trade or business operations whether in the form of debt or equity. An unrelated person is any person whose relationship to the transferor, the transferee, or any member of the family of either is not described in section 267(b) of the Internal Revenue Code, provided that for purposes of this section the term "fiduciary of a trust" as used in section 267(b) does not include a bank as defined in section 581 of the Internal Revenue Code. A restriction imposed or required to be imposed by Federal or State law is not an applicable restriction. An option, right to use property, or agreement that is subject to section 2703 is not an applicable restriction.

(c) *Effect of disregarding an applicable restriction.* If an applicable restriction is disregarded under this section, the transferred interest is valued as if the restriction does not exist and as if the

rights of the transferor are determined under the State law that would apply but for the restriction. For example, an applicable restriction with respect to preferred stock will be disregarded in determining the amount of a transfer of common stock under section 2701.

(d) *Examples.* The following examples illustrate the provisions of this section:

*Example 1.* D owns a 76 percent interest and each of D's children, A and B, owns a 12 percent interest in General Partnership X. The partnership agreement requires the consent of all the partners to liquidate the partnership. Under the State law that would apply in the absence of the restriction in the partnership agreement, the consent of partners owning 70 percent of the total partnership interests would be required to liquidate X. On D's death, D's partnership interest passes to D's child, C. The requirement that all the partners consent to liquidation is an applicable restriction. Because A, B and C (all members of D's family), acting together after the transfer, can remove the restriction on liquidation, D's interest is valued without regard to the restriction; *i.e.*, as though D's interest is sufficient to liquidate the partnership.

*Example 2.* D owns all the preferred stock in Corporation X. The preferred stock carries a right to liquidate X that cannot be exercised until 1999. D's children, A and B, own all the common stock of X. The common stock is the only voting stock. In 1994, D transfers the preferred stock to D's child, A. The restriction on D's right to liquidate is an applicable restriction that is disregarded. Therefore, the preferred stock is valued as though the right to liquidate were presently exercisable.

*Example 3.* D owns 60 percent of the stock of Corporation X. The corporate by-laws provide that the corporation cannot be liquidated for 10 years after which time liquidation requires approval by 60 percent of the voting interests. In the absence of the provision in the by-laws, State law would require approval by 80 percent of the voting interests to liquidate X. D transfers the stock to a trust for the benefit of D's child, A, during the 10-year period. The 10-year restriction is an applicable restriction and is disregarded. Therefore, the value of the stock is determined as if the transferred block could currently liquidate X.

*Example 4.* D and D's children, A and B, are partners in Limited Partnership Y. Each has a 3.33 percent general partnership interest and a 30 percent limited partnership interest. Any general partner has the right to liquidate the partnership at any time. As part of a loan agreement with a lender who is related to D, each of the partners agree that

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the partnership may not be liquidated without the lender's consent while any portion of the loan remains outstanding. During the term of the loan agreement, D transfers one-half of both D's partnership interests to each of A and B. Because the lender is a related party, the requirement that the lender consent to liquidation is an applicable restriction and the transfers of D's interests are valued as if such consent were not required.

*Example 5.* D owns 60 percent of the preferred and 70 percent of the common stock in Corporation X. The remaining stock is owned by individuals unrelated to D. The preferred stock carries a put right that cannot be exercised until 1999. In 1995, D transfers the common stock to D's child in a transfer that is subject to section 2701. The restriction on D's right to liquidate is an applicable restriction that is disregarded in determining the amount of the gift under section 2701.

[T.D. 8395, 57 FR 4276, Feb. 4, 1992; T.D. 8395, 57 FR 11265, Apr. 2, 1992]

### § 25.2704-3 Effective date.

Section 25.2704-1 applies to lapses occurring after January 28, 1992, of rights created after October 8, 1990. Section 25.2704-2 applies to transfers occurring after January 28, 1992, of property subject to applicable restrictions created after October 8, 1990. In determining whether a voting right or a liquidation right has lapsed prior to that date, and for purposes of determining whether the lapse is subject to section 2704(a), taxpayers may rely on any reasonable interpretation of the statutory provisions. For transfers of interests occurring before January 28, 1992, taxpayers may rely on any reasonable interpretation of the statutory provisions in determining whether a restriction is an applicable restriction that must be disregarded in determining the value of the transferred interest. For these purposes, the provisions of the proposed regulations and the final regulations are considered a reasonable interpretation of the statutory provisions.

[T.D. 8395, 57 FR 4277, Feb. 4, 1992; T.D. 8395, 57 FR 11265, Apr. 2, 1992]

### PROCEDURE AND ADMINISTRATION

#### § 25.6001-1 Records required to be kept.

(a) *In general.* Every person subject to taxation under Chapter 12 of the Internal Revenue Code of 1954 shall for the

purpose of determining the total amount of his gifts, keep such permanent books of account or records as are necessary to establish the amount of his total gifts (limited as provided by section 2503(b)), together with the deductions allowable in determining the amount of his taxable gifts, and the other information required to be shown in a gift tax return. All documents and vouchers used in preparing the gift tax return (see § 25.6019-1) shall be retained by the donor so as to be available for inspection whenever required.

(b) *Supplemental data.* In order that the Internal Revenue Service may determine the correct tax the donor shall furnish such supplemental data as may be deemed necessary by the Internal Revenue Service. It is, therefore, the duty of the donor to furnish, upon request, copies of all documents relating to his gift or gifts, appraisal lists of any items included in the total amount of gifts, copies of balance sheets or other financial statements obtainable by him relating to the value of stock constituting the gift, and any other information obtainable by him that may be necessary in the determination of the tax. See section 2512 and the regulations issued thereunder. For every policy of life insurance listed on the return, the donor must procure a statement from the insurance company on Form 712 and file it with the internal revenue officer with whom the return is filed. If specifically requested by an internal revenue officer, the insurance company shall file this statement direct with the internal revenue officer.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 7012, 34 FR 7691, May 15, 1969; T.D. 7517, 42 FR 58935, Nov. 14, 1977]

#### § 25.6011-1 General requirement of return, statement, or list.

(a) *General rule.* Every person made liable for any tax imposed by Chapter 12 of the Code shall make such returns or statements as are required by the regulations in this part. The return or statement shall include therein the information required by the applicable regulations or forms.

(b) *Use of prescribed forms.* Copies of the forms prescribed by paragraph (b)